TOBACCO INTERNATIONAL—5

20—JULY 22, 1988

Product liability movement may really be weaker after *Cipollone*

By Roy A. Burry

The extremely strong industry fundamentals providing tobacco companies with strong profit comparisons have become increasingly visible throughout the 1987-88 period. These include:

- extremely favorable rates of price improvement, widening domestic profit margins;
- growing worldwide cigarette demand in combination with excellent market share expansion throughout the world;
- accelerating excess tobacco cash flow resulting from rising domestic profitability and declining capital expenditures supporting cigarette manufacturing facilities; and
- a large portion of total earnings generated by domestic operations, in turn permitting major benefits from lower 1987-88 tax rates.

Profit progress acceleration stemming from the above factors is permitting major investment in both non-U.S. tobacco and non-tobacco businesses. In addition, worldwide consumption and the market shares of certain companies may benefit significantly from a new cigarette product to be introduced before the end of 1988.

Rather than attempting to predict the outcomes of individual suits based upon hard-to-assess trial events, we have provided an overall framework for analysis of the tobacco litigation issue.

The conclusion derived from this analytical framework is that the long-term impact upon the earnings performance and financial condition of the industry will be negligible, and to date no court decision falls outside this logic.

The three principal elements of this argument, discussed in detail in the February 22 issue, are briefly summarized below.

I. The plaintiff's difficulty in winning. The following indicate that tobacco companies will experience very few, if any, serious losses throughout the ongoing period of litigation.

1. Unlimited resources permit the industry to assemble top legal counsel, with vast tobacco liability experience. The plaintiff's counsel, however, typically has not had the benefit of prior experience and invariably is working under uncertain conditions permitting payment of sizable fees only in the event of substantial awards.

In addition to this "unevenness" of legal representation, other factors tip the legal scale in the defendant's favor. First, the adequacy of the warning label required by Congress beginning in 1966 has been tested at the appellate level of the Federal court system and has been consistently ruled preemptive and therefore adequate. Second, it is extremely difficult to prove a causal relationship medically between cigarette smoking and those maladies most often associated with tobacco usage. Third, the "freedom of choice" and "burden of responsibility" arguments used by defense attorneys have proven to be persuasive.

II. The first adverse decision. Whether the recent decision in the New Jersey Cipollone case represents a victory for the plaintiff or defendants is debatable. However, the following factors indicate that investor fears of financial disaster stemming from the industry's first adverse decision are unwarranted.

- Decisions in jury trials do not alter product liability jurisprudence. Although a successful plaintiff argument may indeed draw duplications from other attorneys, common law is not changed through jury trial.
- Class action suits against the tobacco industry are not possible given the lack of commonality and uniqueness associated with those maladies typically associated with cigarette smoking. Thus, each plaintiff must continue to file suit individually under the same product liability law in existence for many years.
- In every case to date, the defendant(s) has been held free of punitive damages, without which the magnitude of any settlement would remain insignifi-

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• A growing number of states are passing legislation designed to limit massive jury awards in product liability cases. Because of the high court cost associated with the filing of usually fruitless suits against tobacco companies, these statutes virtually eliminate the possibility of similar suits.

III. Price flexibility. Even assuming virtually impossible worst case scenarios concerning both the number of product liability suits lost by the industry and the magnitude of awards presented, relatively small cigarette price increases would offset the entire cost to the industry. Almost any cost associated with product liability litigation, no matter how draconian, could be easily offset in view of the revenue magnitude and price flexibility of the tobacco industry.

What happened in the Cipollone case?

For the first time ever, a jury awarded relief to a plaintiff seeking damage from cigarette smoking. On the basis that Liggett's pre-1986 advertising created an expressed warranty contract between it and the consumer that cigarette smoking was not a potential health hazard, the company was ruled in violation of this contract.

The jury also ruled that (1) cigarette smoking was a "proximate" cause of the plaintiff's death and (2) prior to the 1966 imposition of cigarette warning labels, the company should have warned of the potential health hazards of cigarette smoking. However, no award was made on this basis because the consumer was ruled to have been mostly responsible for her own actions.

The charges of conspiracy and fraud were rejected by the jury.

Ample opportunity exists for both sides of this case to claim at least a partial victory.

Conspiracy and fraud denied. Massive documents researched extensively by the plaintiff's attorneys proved fruitless in establishing conspiracy and/or fraud on the part of the cigarette producers. Examined at great cost, these documents failed to establish the plaintiff's contention that the industry was aware of health hazards associated with cigarette smoking and conspired to withhold information and/or mislead the public in this regard. Thus, future plaintiffs, and more important, their attorneys, are discouraged from projecting damages significantly greater than relatively small "sympathy" awards based principally upon ordinary damages. Rejection of the plaintiff's argument in this regard reinforce our contention concerning the extreme difficulty of future plaintiffs to achieve the potentially larger punitive damages.

Small damages. The attorneys' share of the small $400,000 awarded the plaintiff falls far short of break-even level. Total plaintiff costs to date are believed to have been $2-to-$3 million, and expenses during the appeal process have yet to be incurred. Even if substantially lower costs are experienced by future plaintiff law firms operating on contingency, any revenue received, as indicated by the award in the *Cipollone* case may not offset costs. Virtually all suits filed against tobacco companies are initiated by legal firms hoping to obtain a portion (usually one-third) of a massive award. This case, therefore, could discourage the initiation of major future investments of this nature by the legal profession.

Potential reversal on appeal. Violation of express warranty, the only basis upon which the jury awarded damages, is not a unique argument and has been rejected by the court in all prior cases. This tends to support the industry's contention that the jury in the *Cipollone* case was "erroneously" charged by a "hostile" judge with regard to expressed warranty contract law, and therefore Liggett has a high probability of reversal of the decision upon appeal. If the company prevails in this regard, such a reversal would virtually close the door on future arguments of violation of expressed warranty.

Liggett's appeal will be filed during the 30-day period following the June 27, 1988, hearing of final motions by Judge Sarokin, with the earliest possible date for decision at the appeal level being around year end. The primary basis for this appeal is likely to be Judge Sarokin's failure to instruct the jury that Rose Cipollone must have relied on the pre-1986 Liggett advertising as required under express warranty jurisprudence. This appeal to the third circuit in Philadelphia will be one of the most closely watched tobacco actions to date.

What might the industry have lost?

Under pressure from adverse decisions to the plantiff and increasingly restrictive state laws, the number of active suits pending against tobacco companies has declined significantly in recent months, reaching about 100 before the *Cipollone* decision. Its limited magnitude notwithstanding, the damages awarded the plaintiff in the *Cipollone* case represent the first payment ever made by a cigarette producer. It is uncertain at this time whether this highly publicized decision will result in a reversal of the downward movement in filings. This number is closely tracked by industry sources and must be watched carefully in coming months.

The Cipollone case indeed did represent a unique decision with regard to the following two factors.

1. A jury for the first time found that cigarette smoking wa a "proximate cause" of the plaintiff's illness.

2. The jury ruled that the defendant should have warned the plaintiff of potential health hazards associated with cigarette smoking prior to the 1966 imposition of warning labels.

If juries in the many states which operate under different product liability laws than New Jersey can be convinced of both these facts, small awards might be possible even if the plaintiff was found to be mostly responsible for his or her cigarette smoking and health problems.

Violation of expressed warranty remains a key part of product liability law. The decision by the jury to award damages based upon this contract violation could encourage similar arrguments by plaintiffs' attorneys in the future. This possibility, of course, hinges, to a large extent, upon the authenticity of the defendant's contention that Judge Sarokin's charge of the *Cipollone* jury both differs from past charges and was erroneous.

The jury in the *Girton versus American Tobacco* case was decided on the basis that the defendant's failure to warn prior to 1966 did not contribute to the plaintiff's health problems, and it ruled entirely against the plaintiff. Earlier, the judge had ruled that the express warranty argument was not valid and prevented its use by the plaintiff.

Our conclusion. In each tobacco liability suit that reaches the trial stage, the plaintiff's arguments and the outcome may differ at least partially from preceding cases. Nothing in the Cipollone decision, however, falls outside our analytical framework established some time ago and already summarized in this report. Our evaluation of both the nature of this decision and possible results on appeal (and the Girton case) indicate a further ebbing of the product liability issue. There is little or nothing in recent case results indicating a significant long-term risk to the financial position or performance of the tobacco industry. In fact, just the opposite is true.

This conclusion notwithstanding, there is little in the Cipollone decision offering investors the immediate possibility of a major surge in stock valuations from current depressed levels. Some gradual upward revaluation seems possible as always-negative media attention becomes less intense, and stock prices should be buoyed by anticipated and realized strong profit and dividend progress. Nevertheless, the tobacco group will remain volatile in price and responsive to highly publicized events which have as a common source the nature of the product.

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